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CABINET AFFAIRS STAFFING MEMORANDUM

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Date: 1/11/84 **Number:** -------------- **Due By:**

Subject: Cabinet Council on Economic Affairs Minutes November 8, 10, 15, 17, 23, 29, 30 and December 6, 13, 15, 20, 22

	Action	FYI		Action	FYI
ALL CABINET MEMBERS	[ ]	[x]	CEA	[ ]	[x]
Vice President	[ ]	[ ]	CEQ	[ ]	[ ]
State	[ ]	[ ]	OSTP	[ ]	[ ]
Treasury	[ ]	[ ]		[ ]	[ ]
Defense	[ ]	[ ]		[ ]	[ ]
Attorney General	[ ]	[ ]		[ ]	[ ]
Interior	[ ]	[ ]			
Agriculture	[ ]	[ ]	Baker	[ ]	[x]
Commerce	[ ]	[ ]	Deaver	[ ]	[ ]
Labor	[ ]	[ ]	Darman *(For WH Staffing)*	[x]	[ ]
HHS	[ ]	[ ]	Jenkins	[ ]	[x]
HUD	[ ]	[ ]	Mc Farlane	[ ]	[x]
Transportation	[ ]	[ ]	Svahn	[x]	[ ]
Energy	[ ]	[ ]		[ ]	[ ]
Education	[ ]	[ ]		[ ]	[ ]
Counsellor	[ ]	[ ]		[ ]	[ ]
OMB	[ ]	[ ]		[ ]	[ ]
CIA	[ ]	[ ]		[ ]	[ ]
UN	[ ]	[ ]			
USTR	[ ]	[ ]	CCCT/Gunn	[ ]	[x]
			CCEA/Porter	[ ]	[x]
GSA	[ ]	[ ]	CCFA/	[ ]	[x]
EPA	[ ]	[ ]	CCHR/Simmons	[ ]	[x]
OPM	[ ]	[ ]	CCLP/Uhlmann	[ ]	[x]
VA	[ ]	[ ]	CCMA/Bledsoe	[ ]	[x]
SBA	[ ]	[ ]	CCNRE/	[ ]	[x]

REMARKS: Attached for your information are the minutes of the following CCEA meetings:

November 8, 10, 15, 17, 23, 29, 30
December 6, 13, 15, 20, 22

DCI EXEC REG

RETURN TO:

[ ] Craig L. Fuller
Assistant to the President for Cabinet Affairs
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Office of Cabinet Affairs
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L-300B

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

November 8, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Baldrige, Donovan, Pierce, Stockman, Feldstein, Brock, Svahn, Thayer, Lyng, Burnley, Porter, Cicconi, Schneider and Ms. Whittlesey and Ms. Risque.

1. Budget Outlook

David Stockman made a detailed presentation of the current budget situation and outlook. He reviewed the domestic spending control gains we have achieved after three budget rounds during this Administration, noting that we have realized $288 billion in savings over the 1982-86 period compared to the Carter baseline and have achieved a 28 percent cut in domestic discretionary spending. While this represents a massive savings, it is only approximately one half of what the Administration originally requested in its 1981 budget submission.

He also reviewed in considerable detail the specific domestic programs that were affected by the spending reductions legislated, and some of the reasons we succeeded in certain areas and did not in others. He reviewed the sequence of budget requests which the Administration made in the original Reagan budget submitted in February 1981, the FY 1983 and FY 1984 budgets, and the FY 1985 Cabinet budget requests.

He also reviewed in detail the situation with respect to retirement outlays and the impact of inflation, case loads, and real benefit growth on them.

The Council also considered the success the Administration has had in achieving its defense spending requests and its tax reduction proposals. Mr. Stockman summarized the overall budget results, based on current services, of our domestic spending reductions, tax reductions, and defense buildup. He also reviewed the changes in the economic forecasts and technical assumptions since February 1981 and their impact on federal revenues and outlays over the 1982-1986 period.

The Council also looked at the concept of a general government budget and a social insurance budget, with the social insurance budget consisting of those entitlements supported by payroll taxes to finance universal protection against the economic insecurity of retirement, disability, temporary employment and old age sickness. Mr. Stockman presented an array of statistics detailing the growth of spending on the social insurance budget and the composition of spending over time of the general government budget. He also reviewed the respective tax bases that have been used to support these two budgets and what has happened to them over time.

The Council concluded by agreeing to continue its discussion of the implications of these trends for policy at its next meeting.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

November 10, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Baldrige, Donovan, Pierce, Brock, Stockman, Feldstein, Fuller, Lyng, Svahn, Porter, Puritano, Cicconi, Burnley, Schneider, and Gibson.

1. Budget Outlook

David Stockman completed his budget presentation describing the shares of GNP taken by the general government budget over the 1954-1981 period and the outlook for general government spending over the 1981-1991 period. He also described the pattern of spending on the social insurance budget and how it has risen as a share of GNP. He then reviewed the individual elements of the social insurance budget and the progress that the Administration has made with respect to restraining the growth of unemployment insurance, disability, and social security retirement benefits.

The Council focused its discussion on two central questions: (1) What are the economic effects of a large and structural general fund deficit and (2) What are the range of policy measures to address the deficit.

The Cabinet Council's discussion focused on the economic impacts associated with failing to deal with the deficit, the extent to which additional spending reductions could be achieved with respect to domestic discretionary spending, the extent to which further reductions in entitlement programs were feasible, and the outlook for defense spending.

The Council also discussed the need for a dual strategy to cap and generally reduce social insurance spending, and to address the general government deficit. The Council discussed what might be the principal elements of a social insurance spending strategy and the likelihood of Congressional support for a variety of possible initiatives. The Council also discussed the implications for tax policy and the need for a balanced and comprehensive set of budget proposals.

The Council requested Mr. Stockman to prepare a list of the proposals the Administration had made for spending reductions that have not been accepted to serve as the basis for the Council's discussion of this issue at its next meeting.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

November 15, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Block, Baldrige, Donovan, Stockman, Feldstein, Svahn, Porter, Lyng, Abrams, Burnley, Lighthizer, Wright, Wallis, Puritano, Cicconi, and Gibson, Ms. Whittlesey and Ms. Risque.

1. Budget Outlook

The Council reviewed a set of tables, prepared by the Office of Management and Budget, on the FY 1985-88 current services outlook and major budget components and on the major policy options with respect to budget outlays.

The Council also reviewed a chart, prepared by the Council of Economic Advisors, on the set of current services deficits projected by the Administration and various private forecasting organizations based on alternative growth assumptions, as well as a series of alternative spending reduction packages and their impact on the deficit, prepared by the Council of Economic Advisors.

The Council's discussion focused on the growing political awareness of the deficit and a suggestion that the Council recommend the deficit as the Administration's number one domestic priority and establish as a goal a share of the GNP that the deficit should be reduced to over a specified period of time. Much of this discussion focused on various building blocks in a potential deficit reduction program and the extent to which alternative proposals were substantively and politically feasible.

There was also much discussion about the difference between what the President proposed last January in his FY 1984 budget and the 1985 Cabinet requests that have been received in preparation for the President's FY 1985 budget.

Finally, the Council discussed the share of GNP that would bring federal spending and revenues into balance over the long term. The Council agreed to continue its discussion at its next meeting.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

November 17, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Baldrige, Donovan, Stockman, Brock, Darman, Porter, Thayer, Lyng, Abrams, Burnley, Verstandig, Niskanen, Wallis, Wright, Courtemanche, Cicconi, and Gibson, Ms. Heckler and Ms. Risque.

1. Budget Outlook

Secretary Regan briefly reviewed for the Council the latest action of the Senate with respect to increasing the debt ceiling and David Stockman reviewed the latest round of appropriations bills and what they were likely to produce in the way of an anticipated budget deficit for Fiscal Year 1984. There was also considerable discussion about the capacity of the Department of Defense to obligate all of the budget authority authorized and of the 800 items at issue between the House and Senate with respect to the budget appropriation for the Department of Defense.

Secretary Regan summarized the Cabinet Council's discussions in its earlier meetings in developing a budget strategy and the importance of reducing the deficit from the current projected levels. There was discussion of the debate the previous evening in the Senate on the Armstrong-Long proposal for providing the President with enhanced rescission authority. The Administration welcomes the thrust of the proposal but it was pointed out the enhanced authority would not produce outlay savings immediately.

The Council also discussed the economic impact of having privately held federal debt rising at 20 percent a year, and how long this could be sustained over time. Discussion also focused on the impact on interest sensitive sectors such as inventories, housing, producers durables and consumers durables and the impact of the deficit on the strength of the dollar.

There was also discussion of the surpluses state and local governments are currently generating, the financial activities of many major firms in the business sector, and the large amount of capital inflows from abroad.

Finally, the Council discussed the orders of magnitude needed for spending reductions and revenue increases to reduce deficits to an acceptable level as well as the timing of any Administration proposals to substantially reduce the prospective budget deficits.

The Council agreed to review its discussions with the President the following week.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

November 23, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Brock, Feldstein, Svahn, Porter, DeMuth, Healey, Lyng, Baroody, Cicconi, Gibson, Gray, Halpert, Harris, and Li, and Ms. Heckler and Ms. Risque.

1. Report of the Working Group on Financial Institution Reform

Assistant Secretary of the Treasury Healey presented the report of the Working Group on Financial Institution Reform, addressing the major issues involved in the omnibus financial deregulation bill, the Financial Services Competitive Equity Act, (FSCEA) recently introduced by Senator Garn. The report was the first installment of the economic policy study on financial institution reform, commissioned by the Cabinet Council on June 30.

Mr. Healey stated that the most important issue in the bill is the payment of interest on demand deposits. Allowing payment of interest on demand deposits would continue deregulation in the financial industry and benefit small savers who have limited access to more sophisticated interest-bearing accounts. Research over the last ten years shows that concerns about the flow of funds from rural to urban areas are exaggerated. The marketplace has found ways of circumventing the prohibition of interest payment on demand deposits by bank payments of "implicit" interest. Allowing payment of interest on demand deposits however might adversely affect bank earnings. The Working Group supports such payment as a matter of principle, but believes that demand deposit deregulation should be tied to more comprehensive product deregulation.

The Cabinet Council discussed the banks' and the Federal Reserve Board's probable rationale for opposing interest payments on demand deposits. Banks will argue that complete interest rate deregulation without greater asset powers will jeopordize their profitability. The Federal Reserve Board will be concerned with the incentives for banks to engage in riskier loans created by the need to maintain profit margins. The Council also discussed the effect that interest payments would have on the general level of interest rates.

Mr. Healey stated that the Working Group recommends the Cabinet Council: (1) support eliminating reserve requirements on Money Market Deposits Accounts (MMDAs), rather than having Congress authorize the Federal Reserve to pay interest on the reserves held against MMDAs and Super-NOW accounts; and (2) consider payment of interest on all reserve balances only in conjunction with proposals to make them revenue-neutral.

Because the liabilities of banks have been deregulated, fairness suggest that the assets of banks should be also deregulated. That policy however would lead to an annual Federal government revenue loss of approximately $2.5 billion.

The Council discussion revolved around the costs and benefits of achieving a level playing field for money market funds and MMDAs. Mr. Feldstein noted that if the Administration attempted to assure equal competition between money market funds and MMDAs by eliminating reserve requirements for MMDAs, it would expand the money supply. The Federal Reserve would then have to sell bonds which would cause interest rates to rise. Alternatively, if the Administration paid interest on MMDAs, there would be a revenue loss.

Mr. Healey reported that FSCEA would provide Federal Government affirmation of regional interstate banking arrangements, such as that established in the New England states. It was noted that the proposed legislation would not mandate such arrangements, but only remove prohibitions against them. The Working Group recommended that the Council support the legislation, while at the same time urging Congress to establish a nationwide policy for interstate banking activities.

The Council accepted the Working Group recommendation, but raised the question of whether or not a State could prohibit operations of banks from other States within its jurisdiction if the Federal Government removed the prohibition against interstate activities. The Working Group will obtain a legal opinion of the constitutionality of such an action.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

November 29, 1983
8:45 a.m.
Roosevelt Room

Attendees: The Vice President, Messrs: Regan, Donovan, Feldstein, Porter, Abrams, Ballentine, DeMuth, Healey, Jones, Lyng, McCormack, Puritano, Simmons, Baroody, Cicconi, Gibson, Gray, Skancke, McAllister and Ms. Whittlesey.

1. Report of the Working Group on Financial Institutions Reform

Assistant Secretary Healey continued the presentation of the Report of the Working Group on Financial Institutions Reform begun at the Wednesday, November 23 Cabinet Council meeting regarding Senator Garn's omnibus financial deregulation bill, the Financial Services Competitive Equity Act. He briefly summarized the discussion of November 23 regarding: (1) the payment of interest on demand deposits; (2) the payment of interest on required reserves; (3) the preemption of state usury ceilings; and (4) regional interstate banking. The Cabinet Council supported the payment of interest on demand deposits as a matter of principle, but would prefer to link complete deregulation of interest payment on demand deposits with more comprehensive bank services deregulation. The Council also accepted the Working Group's recommendation to eliminate reserve requirements on money market deposit accounts (MMDA's) rather than paying interest on the required reserves, which would increase the Federal deficit by $2 to $3 billion a year. The Council also supported premption of State usury ceilings if states are allowed to reinstate such ceilings, and affirmed Federal support for regional interstate banking agreements. Mr. Healey noted that fifteen States have overridden the usury prohibitions contained in the Depository Institutions Deregulations Act. He noted that the States would have the ability to establish reciprocal agreements with regard to interstate banking.

Mr. Healey explained that Senator Garn's proposal would close a loophole in the definition of credit card fraud to include misuse of an actual or fictitious account number. Credit card fraud exceeds $1 billion annually, and a significant reduction in the fraud could lower interest rates on credit card accounts by as much as one percent.

Mr. Healey noted two other provisions included in Senator Garn's omnibus legislation would: (1) amend provisions in the Consumer Protection Act to provide consumers with more accessible data concerning their costs and responsibilities regarding consumer

leases; and (2) require depository institutions to inform customers of the institution's check holding policies at the time a person opens a new account or deposits a check if the funds will not be available immediately. The Working Group viewed both of these changes favorably, believing they would benefit consumers.

Mr. Healey reported that the Working Group on Financial Institutions Reform will consider three additional issues as it continues the major study on improving financial services competition, commissioned by the Cabinet Council on June 30: (1) the Glass-Steagall Act prohibition against banks underwriting securities; (2) interstate banking; and (3) the relative treatment of foreign banks in the United States compared to U.S. banks and the reciprocal treatment of U.S. banks abroad.

2. Report of the Working Group on the Financial Institution Deregulation Act (FIDA)

Mr. Healey reported that the Working Group on Financial Institutions Reform has held over forty meetings with representatives of financial service providers affected by the Financial Institutions Deregulation Act (FIDA) to determine if any changes should be made in FIDA as it moves through Congress. The Working Group will return to the Cabinet Council with any specific recommendations it believes warrented within thirty days.

He also outlined the major differences between FIDA and Title I of Senator Garn's Financial Services Competitive Equality Act. Unlike FIDA, the Financial Services Competitive Equality Act would: (1) exempt consumer banks from the bill's requirements; (2) define real estate activities to exclude construction activities; (3) institute size limitations preventing the 25 largest banks from acquiring a large insurance company; (4) prohibit a bank holding company from acquiring a thrift in another State; and (5) prohibit States from authorizing State-chartered banks to engage in insurance activities outside the State on a basis different from that authorized for within the State.

3. Report of Working Group on Productivity and Economic Growth

OMB Associate Director Gregory Ballentine presented the report of the Working Group on Productivity and Economic Growth, one of the thirteen studies commissioned by the Cabinet Council on June 30. He stated that productivity is an important indicator of economic success. Economic output will grow as the workforce expands, but productivity growth is source of improvement in economic welfare.

Mr. Ballentine explained that growth in output per hour slowed from a 3.0 percent annual rate in 1948-73 to 0.8 percent in

1973-81; the decline was pervasive, with 70 to 80 percent of the industries surveyed by the Bureau of Labor Statistics experiencing a decline in productivity. Japan, Canada and Western European nations also experienced productivity declines. Intersectoral shifts, a less experienced labor, lower capacity utilization and a slower increase in capital formation accounted for roughly 0.9 percentage points of the 2.2 percentage point decline. Other factors, more difficult to quantify, contributing to the decline, include research and development spending, inflation, the energy shock, and increased regulation.

Mr. Ballentine stated that in the near term the outlook for productivity appears positive; productivity behaves in a cyclical manner and as the economy expands, productivity will increase. In the longer term, capital formation and the rate of inflation will be major determinants of productivity. He suggested that absent large Federal deficits, a return to the productivity growth rates of 1973-81 is possible. He suggested that specific recommendations to improve productivity will be generated by economic policy studies regarding capital formation, Federal credit policy, reaching full employment, and regulation and market intervention.

The Cabinet Council requested that the Working Group on Productivity and Economic Growth review the 46 recommendations for improving productivity made by the National Productivity Advisory Committee.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

November 30, 1983
1:45 p.m.
The Cabinet Room

Attendees: The President, the Vice President, Messrs. Regan, Shultz, Weinberger, Clark, Baldrige, Donovan, Meese, Stockman, Brock, Feldstein, Baker, Svahn, Lyng, Abrams, Burnley, Darman, Gergen, Fuller, Speakes, Verstandig, Porter, Cribb, Oglesby, Wright, Dam, Thayer, Rhodes, and Cicconi and Ms. Heckler.

1. Budget Outlook

Secretary Regan reported that the Cabinet Council had devoted much attention this past month to reviewing the budget outlook and our fiscal policy, and that all Council members agreed it was the most important economic policy issue the Administration will face in 1984. He indicated that the Council's discussions had been based on a presentation by OMB Director Stockman reviewing what has happened to federal spending and revenues under the Reagan Administration placed in the context of the last 30 years. He commended the OMB presentation as one of the most thorough analyses of the budget and its components that has ever been produced.

He observed that when one compares the situation we inherited with respect to inflation, interest rates, economic growth and employment, and compare it to the economic picture that we see today, the change is truly remarkable. Our economy is today on a much sounder foundation than when the President took office and Americans are much more confident about the future of the economy than three years ago. He added that what we must do now is to pursue fiscal and monetary policies that will preserve the gains we have made in reducing inflation and that will provide the foundation for sustained economic growth. Central to achieving this is the budget. He indicated that the Council's sessions in recent weeks had involved lengthy discussions about the situation we face with respect to prospective budget deficits and what we should do about them.

Edwin Meese emphasized that at this time of year there is intense press interest in ferreting out the details of the President's FY 1985 budget, and that in order to keep the

President's options open during the process of putting together the FY 1985 budget we should ensure the budget is not decided through reports in the press. He recommended that we follow a policy of maintaining an absolute blanket on discussing the budget with individuals outside the executive branch. This approach was unanimously adopted.

David Stockman briefly reviewed the current budget outlook noting that under a current services budget we have built-in annual deficits on the order of $200 billion for the foreseeable future. He observed that if we could implement last year's budget proposals calling for $150 billion in spending reductions and $150 billion in contingency taxes over the next three years we could bring the budget deficits down below the $100 billion level by 1988. Unfortunately, Congress gave us few of last year's spending cuts. He then posed two problems. First, the budget submissions from the departments for the FY 1985 budget call for only $50 billion in spending reductions rather than the $150 billion in the FY 1984 budget. The second problem is the need to find ways of better implementing the proposals we made last year.

The President indicated he was concerned that the budget submissions from Cabinet departments suggested we were accepting a business as usual approach to federal spending and that, in his view, basic reform in many federal spending programs is still needed.

The Council's discussion focused on a number of issues including: the success the Administration has had in changing the character of many government programs during its first three years; the areas of the budget where spending increases are occuring; the impact of current and prospective deficits on our balance of trade and on the strength of the dollar in international markets; the merits of a bipartisan effort to address entitlement reform; the emphasis we should place on what we believe is right rather than what we think is doable; the success of many private organizations and churches in efficiently providing services for those in need; the value of a line item veto and impoundment authority in providing the President with enhanced control over spending; and possible changes in the unemployment compensation system. The Council concluded its meeting by reemphasizing that Administration officials should not discuss the specifics of what the Administration will propose in its FY 1985 budget until the President has made his final decision.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

December 6, 1983
8:45 a.m.
Roosevelt Room

Attendees: Mssrs. Regan, Block, Feldstein, Porter, Ballentine, Benjamin, Burnley, Healey, Jones, Knapp, Simmons, Smith, Baroody, Cicconi, Gibson, Platt and McAllister.

1. Report of the Working Group on Federal Credit Policy

OMB Associate Director Gregory Ballentine presented the report of the Working Group on Federal Credit Policy, one of the thirteen economic policy studies commissioned by the Cabinet Council on June 30. He observed that a common element in many proposals for a U.S. industrial policy is increased Federal allocation of credit through either a government-created industrial development bank or direct government intervention in the financial system. The Working Group's findings regarding the growth federal credit programs and their effects on the economy are relevant to the industrial policy debate.

Mr. Ballentine stated that there are two aspects to federal credit activity: the volume of credit activity and the effects of specific credit programs on resource allocation. The Federal participation rate, which measures the ratio of net direct Federal loans, net Federal loan guarantees, and government-sponsored enterprise activities to total funds raised in the credit market averaged 13 percent over the period 1970-77, 17 percent in 1979, 21.5 percent in 1981 and is estimated to be in the range of 23-24 percent in 1983. The largest direct loan programs are concentrated in the agricultural sector -- the Commodity Credit Corporation, the Farmer's Home Administration and the Rural Electrification Administration, with guaranteed loan activity focused on the housing sector. Sixty-five percent of guaranteed loans are attributable to the Federal Housing Administration, low rent public housing, and the Veterans Administration. He noted that guaranteed loans have less economic effect than direct loans on resource allocation.

Mr. Ballentine stated that the amount of the subsidy offered by the direct loans varies greatly, depending on the particular program. The subsidy contained in a rural housing insurance fund loan is about 65 percent of the loan value, housing for the handicapped about 35 percent of the loan value, and Export-Import

Bank loans about 18 percent of the loan value. A sectoral approach reveals that households receive approximately 25 percent of the value of Federal direct and guaranteed loans, business about 15 percent and farming about 40 percent.

Mr. Ballentine explained that there are three major reasons for the growth of federal credit activity:

1. Many believe that Federal credit is costless because direct loans are often offered at Treasury's borrowing rate plus a premium and guaranteed loans involve no budget expenditures, except in the case of default.

2. The lack of formal budgetary control permits the credit programs to escape the scrutiny applied to direct Federal spending programs. The Congressional budget resolution credit aggregates are not binding.

3. The beneficiaries of the programs are clearly identifiable and well-organized groups, which will resist change with considerable vigor.

He outlined three major areas for improvement of Federal credit programs:

1. Supporting Congressional efforts to place the off-budget activities of the Federal Financing Bank (FFB) on-budget and allocating FFB activities to the originating agencies.

2. Making the credit aggregates in the Congressional budget process binding; and

3. Revising OMB Circular A-70, which was issued in 1965 and has not been revised since.

The Working Group recommended that the following principles be incorporated into the revised A-70:

- Requiring direct Federal loans to bear a rate comparable to the market rate (not the Treasury rate);

- Requiring guaranteed loan fees to cover servicing and administrative costs and the full expected Government liability in the event of default;

- Providing Government loan guarantees in a manner that encourages competition between lenders and results in the lowest interest rate to the borrower;

- Expanding co-insurance on guaranteed loans by: (a) requiring lenders to bear a significant portion of the risk; and (b) not subordinating the Government's claim to that of the lender in the event of default; and

- o Not offering direct or indirect Federal guarantees for securities with tax-exempt status.

The Council asked the Working Group to draft a revised Circular A-70, incorporating the recommended principals. The Council will present the revised circular and the other general credit policy recommendations to the President for his consideration.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFARIS

December 13, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Block, Donovan, Baldrige, Feldstein, Porter, Wright, Abrams, Burnley, Collins, DeMuth, Gray, Horowitz, Rose, Simmons, Baroody, Cicconi, Donnelly, Gibson and McAllister, and Ms. Whittlesey.

1. Report of the Working Group on Regulation and Market Intervention

Christopher DeMuth presented the report of the Working Group on Regulation and Market Intervention, one of the thirteen studies commissioned by the Cabinet Council on June 30. He stated that the Federal Government does not possess a Cabinet-level process for establishing regulatory plans and priorities. Unlike the budget process, there is no mechanism through which the aggregate costs and benefits of regulations can be considered. Instead, regulatory decisions are made in an incremental manner, with little consideration for total Government demands on the private sector. He noted that the principles for such a process have already been established; the final report of the Vice President's Task Force on Regulatory Relief applied the general economic efficiency (cost-benefit) criteria of Executive Order 12291 to particular regulatory issues and programs by developing ten regulatory policy guidelines.

Mr. DeMuth observed that in the last 15 years health, safety and environmental regulations have grown dramatically, while the older forms of economic regulation, such as the price, entry and exit controls exercised by the Interstate Commerce Commission (ICC), the Federal Communications Commission (FCC), and the Civil Aeronautics Board (CAB) have been reduced.

Mr. DeMuth stated that in his view the Administration has been very successful in managing the regulatory process; the rate of new regulations issued has dropped sharply -- by between a quarter and a third compared to the Carter Administration. The Vice President's Task Force has also been successful in revising or eliminating a number of existing statutory regulations. These initiatives include the Department of Labor's Davis-Bacon Act reforms, the Depository Institutions Deregulation Committee's elimination of most remaining controls on interest rates on commercial bank accounts, the Department of Energy's elimination of energy conservation rules, the National Highway Traffic Safety Administration's (NTHSA)

rescission of certain automobile design requirements, and the President's prompt removal of petroleum price controls. He suggested however that the Administration has been less successful in challenging the underpinnings of many of the health, safety, and environmental regulations.

Mr. DeMuth stated that the Administration will face a number of important regulatory issues in the next year, including preserving many of the economic regulation reforms already enacted and resisting further regulations initiated by Congress. These include preventing the reversal of many of the airline deregulation steps and opposing the passage of legislation preventing the FCC from reforming telephone rates.

Mr. DeMuth suggested that a means of improving the quality of the Federal Government's review of regulations would be to establish a regulatory planning process. Such a process would utilize the current Unified Regulatory Agenda, a document outlining Federal agency plans for new regulations over the coming year, to summarize the regulatory agency's priorities. The agencies and the Office of Management and Budget would review the plans and priorities bringing major disagreements for Cabinet-level review.

The Council's discussion focused on a number of issues, including the difficulty of enacting regulatory relief. Several members observed that Federal regulation is often used to protect businesses from competition. They also pointed out that Federal regulation is pervasive, ranging from Food and Drug Administration definitions of food to the Internal Revenue Service's interpretation of tax legislation. The Cabinet Council asked Messrs. DeMuth and Porter to develop a specific proposal for a Cabinet-level review of the Federal Government's regulatory plans and priorities for further Cabinet Council consideration.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

December 15, 1983
8:45 a.m.
Roosevelt Room

Attendees: Mssrs. Regan, Donovan, Block, Brock, Feldstein, Porter, Abrams, Ballentine, Chapoton, Jones, Berg, Cicconi, Gibson, Lindsey, McAllister, Neal, Platt and Li, and Ms. Whittlesey.

1. Report of Working Group on Capital Formation

Martin Feldstein presented the report of the Working Group on Capital Formation, one of the thirteen studies commissioned by the Cabinet Council on June 30. He stated that increasing the rate of capital formation in the United States must be a continuing long-run goal of economic policy if the United States is to maintain international competitiveness and a rising standard of living.

Mr. Feldstein stated that for 1983 the growth in net investment in plant and equipment probably will be less than previous experience. A Department of Commerce survey of business investment plans suggests that there will be no aggregate increase in net investment in plant and equipment over the next six months. By contrast, net investment increased by 6 percent from the fourth quarter of 1982 to the fourth quarter of 1983. An analysis of the sources and uses of capital in the U.S. suggests that investment as a share of GNP will decline from the 1970-79 average of 2.9 percent to 1.1 percent. Federal deficits as a percent of GNP will increase from the 1970-79 average of 1.7 percent to 5.8 percent in 1983.

Mr. Feldstein reviewed the differences in net fixed investment between the U.S. and our major trading partners. U.S. net fixed investment averaged 6 percent of GNP over the 1970's, compared to an average of 10.7 percent for major European trading partners and 19.5 percent for Japan. These differences in net fixed investment correspond with differences in the growth rate of manufacturing productivity. Noting that the 12 percent average real pre-tax rate of return on U.S. investments is higher than in Europe or Japan, he suggested that the relatively low rate of capital formation in the United States is attributable to policies that discourage savings.

Mr. Feldstein stated that the Administration has adopted a number of policy changes that remove disincentives for savings, including major tax changes, financial deregulation and increased investment in research and development (R&D).

The most significant tax changes include the 23 percent reduction in tax rates, expanded and increased individual retirement account (IRA) deductions, the accelerated cost recovery system, and the virtual elimination of the estate tax. He suggested that the dramatic reduction in inflation has an effect on savings and capital formation four to five times greater than the tax reductions. Less inflation has increased the value of the tax reductions and reduced the uncertainty in investment decision making.

Mr. Feldstein observed that, in his opinion, the prospective Federal budget deficits are the major remaining barrier to increased capital formation. The 1983 deficit as a share of GNP will be 5.8 percent, with a 1981-85 average of 4 percent of GNP. The harmful effects of the deficit however will be mitigated somewhat by capital inflows from abroad, which are estimated to be roughly 1 percent of GNP in 1983 and 2 percent in 1984.

Mr. Feldstein outlined a series of possible policies to increase capital formation, some of which were considered by the Cabinet Council last January. These include: indexing the IRA maximum contribution; indexing the capital income exclusion; limiting the consumer interest deduction; indexing depreciation deductions; and temporarily waiving the IRA ceiling.

The Cabinet Council expressed particular interest in two proposals: (1) Allowing temporarily a nondeductible contribution to and IRA (perhaps $2,000 per year for the next five years), in addition to the current $2,000 deduction permitted. The House Ways and Means Committee included a provision permitting an annual $1,750 nondeductible contribution in its recent tax bill. The interest on the contribution would not be taxed until withdrawn. (2) Developing an instrument to specifically encourage low-income individuals to save more.

The Cabinet Council will review the Working Group's policy options and recommendations at greater length at a future meeting.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

December 20, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Bell, Brock, Feldstein, Porter, Ford, Jones, Lyng, Simmons, Baroody, Benjamin, Cicconi, Cogan, Gibson, McAllister, Neal, Platt, and Li, and Ms. Whittlesey and Ms. Risque.

1. Report of the Working Group on Unemployment and Unemployment Compensation

Mr. Cogan presented a report of the Working Group on Unemployment and Unemployment Compensation which conducted economic policy study number 7: Reaching Full Employment. The Working Group report focused on youth unemployment, reviewing the history of Federal youth employment and training programs, discussing the effects of the Federal minimum wage on youth employment, and presenting for Cabinet Council decision two issues: (1) a proposal to establish a national school-to-work transition program; and (2) extension of the Targeted Jobs Tax Credit program.

Mr. Cogan noted that despite the plethora of Federal programs over the years designed to reduce youth unemployment, including public service employment, tax credits, and job skill training programs, youth unemployment remains stubbornly high. In fact, the youth unemployment rate today is approximately as high as it was immediately after World War II.

The Reagan Administration's major effort to reduce youth unemployment is embodied in the Job Training Partnership Act (JTPA) of 1982. Mr. Cogan estimated that a total of about $2.4 billion is being spent in FY1984 on youth employment and training programs, including JTPA block grants, the Summer Youth Employment Program, Job Corps, and available funds from the Employment Service.

National School-to-Work Transition Program

The first issue presented for Cabinet Council discussion was a proposal to establish a national school-to-work transition program modeled after a demonstration started in Delaware by Governor du Pont and now replicated in seven other States as the Jobs for America's Graduates (JAG) program. The JAG model

is designed to serve high school seniors not planning to pursue post-secondary school education and who are likely to experience difficulty finding a job after graduation. The program places counselors and job specialists in local high schools to provide participating seniors with job search assistance.

Mr. Cogan pointed out several problems with the evaluations and field reviews of JAG and its predecessor, Jobs for Delaware Graduates (JDG). The 88 percent JDG placement rate includes participants who attend post-secondary school and enlist in the military. Adjusting for those factors results in a 42 percent placement rate, which is still much better than the rate under the Comprehensive Employment and Training Act of 1973. However, a field review revealed that many of the participants considered placed in jobs were people working in the same job they held during school or in the previous summer.

The Working Group presented two options:

(1) Proposing or supporting separate legislation to authorize a national school-to-work transition program at $300 million in FY1985, increasing to $1 billion in FY1988; or

(2) Encouraging States and localities to use existing authority and flexibility to establish school-to-work transition programs modeled after JAG.

The discussion noted the creativity of Governor du Pont in developing the JAG program, and several considerations in whether to recommend a federal national program:

(1) The program would require large budget resources at a time when the need to reduce federal budget deficits is acute.

(2) Congress would likely expand the scope and cost of the program.

(3) The program would not address the needs of the 26-27 percent of students entering the 9th grade who eventually do not graduate from high school.

(4) There already exists substantial flexibility in JTPA and the Wagner-Peyser Act, as amended, for States and localities to establish school-to-work transition programs modeled after JAG if they choose.

The Council recommended that the Administration encourage States and localities to use existing authority to establish school-to-work transition programs. The Council also recommended that the Administration strongly press for its proposals for a job voucher and youth employment opportunity wage in the State of the Union Address and in the upcoming session of Congress.

Targeted Jobs Tax Credit

The second issue for Cabinet Council decision was whether the Administration should support an extension of the Targeted Jobs Tax Credit (TJTC) in the FY1985 budget, and if so, how long an extension. Mr. Cogan presented three options:

(1) Not proposing extension of TJTC in the FY1985 budget and delaying a policy decision until the Congress holds hearings on the program;

(2) Proposing extension of TJTC for one year in the FY1985 budget; or

(3) Proposing extension of TJTC for five years in the FY1985 budget.

The Council discussed the types of firms that are using the credit. There is evidence which indicates that large service businesses use the credit most often. The paperwork requirements often discourage small businesses from utilizing the credit. The Department of Labor is conducting a one year study of the program. The Council supported proposing a one year extension of TJTC while waiting for the results of the Department of Labor study.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

December 22, 1983
8:45 a.m.
Roosevelt Room

Attendees: Messrs: Regan, Block, Porter, Wright, Burnley, Ford, Horowitz, Lighthizer, McCormack, McNamar, Moran, Olson, Thompson, Gibson, Cicconi, Platt and McAllister, and Ms. Risque.

1. Administration's FY 1985 Economic Assumptions

Secretary Regan distributed the Administration's economic assumptions for FY 1985. Real GNP is assumed to grow 4.5 percent, measured from fourth quarter to fourth quarter, in 1984, and 4.0 percent a year from 1985-1988. The assumptions were not changed to reflect the December 21 release of the GNP "flash report" indicating a less than expected 4.5 percent real growth rate in the fourth quarter. He emphasized that the assumptions are not strictly forecasts but rather policy goals. The President for example insisted that the assumptions include a declining GNP deflator over the period 1984-89, not necessarily as a forecast but as a goal.

2. The Desirability of the GNP Flash Report

Several Council members expressed skepticism about both the economic and policy value of the "flash" real GNP growth report, which is based on only one month's data. Secretary Regan requested that a working group be established to study the desirability of the "flash" report, consulting with private-sector forecasters to determine if the "flash" is useful to their efforts.

3. Report of the Working Group on the Federal Budget

Mr. Porter stated that the Working Group on the Federal Budget had prepared for the Cabinet Council's consideration several options regarding enhanced Presidential spending authority, as requested by the Council at its October 20 meeting. He explained that there are three major issues involved in a proposal for enhanced Presidential spending authority. The first is the appropriate form of such a proposal: a constitutional amendment; a statute providing for enhanced rescission authority; or both. He noted that in November, Senators Armstrong and Long proposed an amendment to the Olympic Coin duty suspension bill that would have increased the President's rescission authority. The amendment was tabled by a vote of 49-46 with 37 Republicans and 9 Democrats voting against tabling, including 8 members of the Appropriations Committee.

Mr. Porter explained that the second major consideration is the nature of an Administration proposal: an endorsement of the concept of enhanced Presidential spending authority and a statement of willingness to work with Congress in developing legislation or making a specific legislative proposal. The third major consideration is the scope of a proposal; would it be limited to appropriations bills or also affect entitlement programs and other authorizations?

Mr. Wallison reviewed several possible alternatives for enhanced Presidential rescission authority, including:

- o Repealing existing rescission law and substituting for it a provision under which a rescission would be effective unless overturned by legislation, subject to veto, within 45 days. He noted that this approach would substantially increase the power of the Chief Executive.

- o Restricting the President's enhanced rescission authority by limiting rescissions to budget authority or outlays in excess of that proposed in a corresponding line item in the President's budget. An alternative restriction might be the Armstrong-Long provision limiting rescission authority to 80 percent of the previous year's funding and not permitting the President to reduce entitlement benefits, although cost of living adjustments could be affected. A similar restriction could be placed on the President's ability to rescind budget authority if Congress has reenacted the authority.

- o Permitting the President enhanced rescission authority if the President determines that outlays are proceeding at a pace that would cause total outlays for a fiscal year to exceed some specific baseline. Potential baselines include total projected outlays in the President's budget, a specified percentage of GNP, the deficit, or some percentage of the previous year's budget authority or outlays.

The Council's discussion focused on several issues, including: the relative merits of a line-item veto authority and enhanced rescission authority; the value of specifically excluding the social security program from rescission proposals; and the effect of a proposed line item veto constitutional amendment on the impetus for a balanced budget/spending limitation constitutional amendment.

The Cabinet Council agreed to recommend to the President that he include in his State of the Union Address: (1) a reference to his desire for a balanced budget amendment; and (2) a request for enhanced Presidential spending authority, the specifics of which would be communicated later.

Secretary Regan emphasized the importance of consulting with White House senior staff on this sensitive issue.